Summary

By all accounts, marketing fresh fruits and vegetables has been transformed. First, consumer demand has increased for greater variety and quality in fresh produce. Second, supermarkets have merged, acquired new stores, and grown larger. Third, anecdotal evidence suggests that the role of merchant wholesalers in produce has become less important while that of the foodservice sector has increased. And fourth, nonprice provisions such as marketing fees have grown increasingly common in transactions between retailers and grower-shippers.

ERS's study of the produce industry aimed to answer several questions. What is the current state of the produce industry? How do produce shippers and retailers conduct business? And is the increased use of different types of marketing fees the result of growing retailer influence or business efficiencies?

The scarcity of public data led ERS to use a three-pronged approach.

- ERS collaborated with Cornell University, and exhausted the public domain for data describing the fresh produce industry; these results are published in the ERS report, *Understanding the Dynamics of Produce Markets: Consumption and Consolidation Grow*, August 2000.
- Because data on transactions between shippers and retailers are scarce, ERS—in collaboration with the University of California, Davis; University of Arizona, and University of Florida—conducted interviews of shippers, retailers, and wholesalers for information on marketing of grapes, oranges, grapefruit, tomatoes, lettuce, and bagged salad. While the small number of interviews warrant caution in interpreting the findings, the research enhances understanding of recent changes in produce marketing. Results from this portion of the project are published in *U.S. Fresh Fruit and Vegetable Marketing: Emerging Trade Practices, Trends, and Issues*, January 2001.
- ERS contracted studies with university researchers to assess the pricing by retailers for some fresh produce commodities in selected markets. Timothy Richards and Paul Patterson (Arizona State University) investigated supermarket retailer behavior in the selling and buying of Washington apples, California oranges, California grapes, and Florida grapefruits in *Competition in Fresh Produce Markets: An Empirical Analysis of Channel Performance,* published by ERS in September 2003. Richard Sexton, Mingxia Zhang, and James Chalfant (University of California, Davis) examined the market for California and Arizona iceberg lettuce, packaged salads, and Florida and California tomatoes in *Grocery Retailer Behavior in the Procurement and Sale of Perishable Fresh Produce Commodities*, published by ERS in September 2003.

U.S. produce markets have evolved considerably since the 1980s. Per capita consumption of fresh fruits and vegetables increased 6 percent between 1987 and 1995, and 8 percent between 1995 and 2000. New products were introduced to meet burgeoning consumer demand, and as a result, the average produce department is larger. The marketing channels have changed also. The share of produce volume sold directly by grower-shippers to retail supermarkets has increased, as have sales to the foodservice sector.

Mass merchandisers, emphasizing everyday-low-price strategies, have provided new competition for supermarkets. In response, large supermarket retailers have emphasized customer service while pursuing efficiency gains and lower capital investment costs. Many of them have merged or acquired other chains, citing the potential for lower costs through streamlined operations, volume discounts in buying, and exclusive partner relationships. Consolidation through mergers and acquisitions by grocery retailers has produced a significant increase in the share of total U.S. grocery store sales by the largest firms.

Coincident with these changes were new provisions in retailer-shipper transactions. Most controversial is the "slotting fee," where suppliers pay a lump sum to retailers for introducing their new products to the supermarket shelves. The use of fees and services is controversial. Some argue that they are a manifestation of retailers' market power over shippers, while others suggest the various fee and service requests have efficiency-based motives. Because both points of view are valid, empirical evidence is needed to provide greater insight into the factors underlying fees and retail consolidation. To date, no comprehensive empirical studies have examined these issues, largely because transaction data are proprietary. Thus, the issue remains unresolved.

To assess emerging practices in the produce sector, such as retailers' requests that shippers pay slotting fees or provide services like customized containers, it helps to understand the importance of retailer market power. If they possess little or no market power, then fee and service requests must be driven by efficiency concerns, in which case policy response is inappropriate. If market power exists, fees and services may be a symptom of that market power, but the appropriate policy remedies may not focus on disallowing use of such fees and services so much as the exertion of market power itself. If retailers hold market power over grower-shippers or consumers, banning the use of particular fees and/or services may simply cause that power to be manifested elsewhere, such as in lower acquisition prices, and perhaps at the cost of reduced efficiency.

Econometric analysis indicated that retailers do influence prices paid to fresh produce shippers and by consumers for some commodities. Retailer ability to hold shipper prices below competitive prices was evident for grapefruit, apples, and lettuce, but not for tomatoes, grapes, and oranges. Consumer prices in excess of purely competitive prices were evident for apples, oranges, grapefruit, fresh grapes, tomatoes, and lettuce.

ERS' multiphase project has provided a deeper understanding of the relationship between retailers and shippers, ranging from the form of the transaction to the degree of retailers' influence over prices paid to shippers for some products. Despite these advances, several important questions remain. Specifically, does the presence of market power engender new trends in marketing, such as direct buying from grower-shippers, supply chain management, and fees and services? Or are they the outcome of efforts to gain distribution efficiencies? Making that determination requires additional research.